Bargain Hunt – CVAs and the future of corporate rescue

Introduction

As many readers will be aware, the BBC broadcasts a programme called "Bargain Hunt". The premise of the programme is that motivated amateurs, under the guidance of experts, make various acquisition decisions hoping that they have an eye for a bargain. The contestants have only a very limited amount of time to make their decisions. Subsequently, the experts, who are provided with further time, then make decisions for themselves without the same urgency. The experts, with the benefit of their knowledge and experience, and more time, invariably make better decisions than the contestants. The items purchased are then sold at auction. The auctioneer, a totally independent party, often has a scathingly negative opinion of the decisions of the contestants (and experts).

Bargain Hunt has fewer successes than failures. Another programme, "Flog It!" involves members of the public selling their own goods at auction for what they hope will be a profit. Sometimes it goes well, often it does not. In this article, we loosely suggest that Company Voluntary Arrangements ("CVAs") might be viewed as the insolvency equivalent of Bargain Hunt whilst connected party pre-packs might bear some comparison with Flog It! Both have their places but neither can match the relative successes of "Antiques Road Trip", where experts, who have plenty of time to consider their purchases, travel around buying and selling goods. Antiques Road Trip might be viewed as the equivalent of a trading administration.

We intend to explain in outline terms the main findings and recommendations we made in 2018 when we, along with our colleague, Dr Lezelle Jacobs, conducted a wide-ranging research project on behalf of R3 (with the sponsorship of ICAEW and the support of the Insolvency Service) looking at how successful CVAs were in practice in which we examined over 500 CVAs. The full report is available on the R3 website. We shall also consider recent and prospective developments in the law and practice relating to CVAs.

Is a CVA a Bargain? - The Main Findings of the 2018 Report

Around two thirds of CVAs examined were terminated early. Although that headline figure does not sound very promising, one third were implemented or still trading after more than four years and we found that in many terminated CVAs a dividend was still paid. We found that in many terminated CVAs a dividend was still paid. Such dividends, although less than that promised by the CVA, were likely to be more than might have been paid if the company had entered into a connected party pre-pack administration instead of the CVA. There was something to be said for company participators who were trying to rescue their companies, and trying to pay a reasonable dividend to their creditors.

CVAs with benefit of a moratorium, and which therefore had the benefit of more time to plan the CVA proposal, appeared to be more likely to be completed than cases where no moratorium was used.

Many stakeholders were not convinced that the opinion of the nominee insolvency practitioner as to the likely feasibility of the CVA was entirely reliable, especially in cases where the nominee had been significantly involved in the drafting of the CVA proposal.

CVAs are often found to have been unrealistic. Creditors, usually led by HMRC required an unrealistically high dividend for unsecured creditors (such as 100%). Often the consequence of this requirement led to an overly long CVA duration of up to 5 years. Many companies found it impossible to trade successfully whilst subject to a CVA for such a long period of time.

Landlords and CVAs

Although our empirical study did not include any largescale retail CVAs, it was clear from the interviews we conducted that a number of landlords found the operation of CVAs to be lacking in clarity as far as their rights were concerned and often felt that the results were unfair. Our report found that although landlords were not always happy with the terms of a CVA, they were generally willing to accept a reduced rent rather than take back the property, as any prospective tenant would be unlikely to offer more rent than offered in the CVA.

In *Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2019] EWHC 2441 (Ch), the court considered whether the terms of the Debenhams CVA were unfairly prejudicial to some of its landlords. The court explained its approach was to consider the particular facts of each case in deciding whether a CVA is fair or not. The *Debenhams* case involved the common type of retail CVA, where the CVA's terms create different classes of landlords of retail units and treat those classes differently from other unsecured creditors, as well as differently *inter se*. The problem faced by many retailers is that long term leases often provide for upwards only rent reviews without any break clauses. This type of lease has led to many retail units being "over rented", that is, where the rent payable under the lease is greater than the market value of the unit.

Under the *Debenhams* CVA those units which were financially sustainable at the contract rate remained largely unaffected by the CVA, with full rent continuing to be paid during the CVA. Those units which were shown not to be sustainable at the contract rate had their respective rents reduced to a level which made them financially sustainable. The reduction in rent payable for the duration of the CVA was not lower than the market rent available at the time of the CVA. All landlords were given the right to terminate their leases if they did not wish to accept the lower rent. The court looked at the "basic fairness" of the CVA and judged it fair in the round. The court was satisfied that the differential treatment of the landlords was justified on the facts to secure continuation of the business.

Recommendations and Prospective Reforms

The positive outcomes of CVAs following a moratorium suggest companies would benefit from wider use of this breathing space. The existing options, under Schedule A1 of the Insolvency Act 1986 for small companies or administration under Schedule B1, are rarely encountered in practice due to the onerous provisions, costs and other challenges they present. A new pre-insolvency moratorium is desirable. A flexible moratorium would allow fuller scrutiny of any CVA proposals free from immediate creditor pressure. This scrutiny could include the feasibility of the proposed length of CVA. With a typical CVA proposed for five years, but a quarter of users being less than four years old at commencement, it is not surprising that the majority are terminated early.

The previous Government had committed to introduce a pre-insolvency moratorium, and repeal the under-used Schedule A1 process. It remains to be seen if the new Government will proceed with these plans. Should it do so, its success will depend in part on engagement and education of directors to ensure its effective, and timely, use. The high level of early CVA terminations suggests insufficient engagement.

There are also proposals to introduce a new cross-class cram-down process in addition, rather than as an amendment, to the CVA. In reality, this will be suited to large companies with complex capital structures. CVAs will continue to offer a "relatively low cost restructuring option" for small companies – its main user group at present. With most CVAs supervised by practitioners undertaking just one or two per year, it would be beneficial to provide assistance to these advisers. A form of standard terms or a checklist could be used to frame the CVA, ensuring a degree of consistency and best practice.

These reform proposals are of increasing significance in light of the current review of the Graham Review reforms. Presently pre-packs are often pursued in preference to a CVA. However, any potential restriction on connected party sales could make a CVA an increasingly viable option. To make this option more successful, the framework needs strengthening.

The role of HMRC as an unsecured creditor was also identified as a hindrance to the success of CVAs, often resulting in unrealistic terms and dividends being proposed. The elevation of HMRC to preferential status may result in more realistic terms being offered, as proposals will legitimately be able to discriminate in favour of HMRC ahead of unsecured creditors. This will, however, depend on there being sufficient funds available after payment to HMRC to put an appealing proposal to the remaining unsecured creditors. This reform may not prove to be such a bargain for the general body of creditors.

Conclusion

Contestants on Bargain Hunt rarely make profitable decisions. Time is short. Expertise has only a limited input into decisions. Where experts are given more time, better decisions are made. If the contestants were given more time and were properly advised by one expert, with the additional input of the ultimate auctioneer, it is likely their quest would be more successful.

If restrictions on connected party pre-packs are introduced, the CVA regime may need to be strengthened. It could be improved in a number of ways: the introduction of a workable pre-insolvency moratorium; time to consider genuine financial and operational changes to a business; creditors, especially public sector creditors such as HMRC, could be more willing to compromise their debt over a shorter period of time; standard form provisions or a checklist, dealing with, for example, the position of landlords, could be made freely available; and more generally all stakeholders could have full confidence that the proposal was independently assessed. CVAs are often a success, even if terminated early. They may be more successful more often, if time, advice and independent adjudication were available.